UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

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IN re: Docket #AO-F&V-991-A3; FV03-991-01

ANHEUSER-BUSCH COMPANIES, INC.
POST-HEARING BRIEF IN OPPOSITION TO PROPOSED MARKETING ORDER

I INTRODUCTION

A. Proposed Hop Marketing Order

In October 2003, Administrative Law Judge Jill Clifton, on behalf of the U.S. Department of Agriculture ("USDA"), conducted a public hearing on the promulgation of a proposed federal marketing order for hops grown in Washington, Oregon, Idaho and California. The hearing was held in Portland, Oregon, October 15-17, and in Yakima, Washington, October 20-24.

The primary purpose of the proposed order would be to establish volume regulation through producer allotments and reserve pooling of excess production.[1] Under the proposed order, an eight-member hop administrative committee ("HAC") would administer the order. USDA would appoint HAC members from a list of industry-elected nominees, and USDA's Agricultural

[1] The proposal would also authorize production research, market research and development projects. USDA AMS News Release No. 210-03.

Marketing Service (AMS) would monitor the order.[2] The program would be financed by assessments, established by USDA upon recommendation by the HAC, which would be levied on hop handlers.[3]

The central feature of the proposed order would be an allotment program under which hop growers would be allocated "allotment base" established by

highest annual production in any given year during the 1997-2002 period.[4] To be eligible to receive allotment base, a grower would have to have produced hops in either the 2001 or 2002 crop year. Under the proposed order, in determining allotment base production would be measured in pounds of alpha acid, rather than pounds of hops, except that production of varieties with an alpha acid content of 10 percent or less would be considered equal to 10 percent of pounds of hops produced.[5]

Each year, the HAC would determine a marketing policy for the ensuing crop year.[6] If the HAC determined that there was a need to limit the quantity of alpha acid to be sold, it would recommend to the Secretary of Agriculture a "saleable quantity", i.e., the total quantity of alpha acid permitted to be sold by the U.S. hop industry as a whole. Upon acceptance by the Secretary, the total saleable quantity would be allocated pro rata among growers holding allotment

For example, if the saleable quantity were set at 50% of the total allotment base held by all hop growers, each grower would only be permitted to

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[2] Id.
[3] Id.
[4] Proposed Order § 991.53(a).
[5] Id. An alternative proposal would allocate allotment base using actual alpha acid content of the varieties produced. 68 Fed. Reg. at 44252 (proposal 9).
[6] Proposed Order § 991.50.

sell hops to a maximum of 50% of that grower's individual allotment base additionâl sales would be prohibited by law.

This would effectively create a cartel of American growers because the amount of hops that could be marketed in a given year would be decided by the HAC (just as the amount of oil to be marketed by OPEC member countries is decided by OPEC). As even proponent committee members admit, allotment base would also become a commodity whereby growers who needed allotment base to sell their crops would have to buy or rent it from growers without demand for their crops.[7]

The proposed order would also restrict increases in total allotment base. The order provides for the HAC each year to make additional allotment base available "in the amount of *no more than* 1 percent of the total allotment base"; half of the additional 1% allotment base would go to existing producers, half to new producers.[8] Moreover, even that minute increase would be waived "in any year in which the current saleable quantity [was] equal to or less than the previous year's saleable quantity."[9]

B. <u>Anheuser-Busch Opposes Proposed Order</u>

Anheuser-Busch strongly opposes the proposed order because it harm U.S. hop growers, not because it would result in higher prices for hops.

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[7] Leslie Roy Tr. 1605, 1614-15; Stephen Carpenter Tr. 97. Other proponents who testified agreed that base would be an expense for growers needing it to sell hops. Michael Smith Tr. 336; Paul Serres Tr. 2025; Duane Desserault Tr. 2300.
[8] Proposed Order § 991.53(e)(1) (emphasis added).
[9] Id.

The testimony of many proponent and opponent hop growers definitively establishes that Anheuser-Busch has paid American hop growers very fair prices resulting in very fair returns for the growers; its purpose for opposing the order cannot be questioned. For example, Tom Gasseling (a Proponent Committee member) testified "throughout this oversupply situation, Anheuser-Busch has been very fair in how they have contracted, how they have treated the growers . . ." He went on to testify Anheuser-Bush is paying "a very, very fair price."[10] Michael Smith, another leading proponent, testified "we have been treated very fairly. And I think I am speaking for the rest of the industry, in that I think A-B has acted very responsibly."[11] As the world's largest brewer and hop purchaser, as well as the largest purchaser of U.S. hops, Anheuser-Busch has a vital interest in a thriving, vibrant U.S. hop industry.

The proposed order would harm the industry because any coordinated U.S. restriction in supply would merely result in higher sales of foreign hops In 2003, proponents' agricultural economics expert testified that only 22.5% of the world's hops were produced by U.S. growers.[12] Moreover, as will be established below, about 70% of U.S. growers' sales are outside the United

[10] Thomas Gasseling Tr. 1973-74.
[11] Smith Tr. 349. Referring to contracts with Anheuser-Busch, another Proponent Committee Member, Leslie Roy, testified that every grower in the industry "would do about anything to keep those contracts." Roy Tr. 1541-42. Additional evidence is in the record on this point.
[12] Dr. Ray Folwell Tr. 894 (54 million lbs. produced in the U.S. vs. 239 million lbs. worldwide).

States.[13] Moreover, many efficient American growers would be less competitive and would receive decreased profits because they would be burdened with purchasing base allotments from growers without demand. As one proponent committee member acknowledged, the cost of purchasing base may drive some growers out of the business completely.[14]

From a policy perspective, it is undisputed that the proposed order would establish a government-mandated hop cartel, and we cannot begin to comprehend how a cartel approach can possibly be reconciled with this Country's economic, agricultural and international trade philosophies and policies in the 21st century. As Dr. Don Kloth of Anheuser-Busch testified, this cartel approach would run counter to this Administration's recently stated agricultural policy that recognizes that "the marketplace is the best guide for allocating resources and provides the most objective reward for efficiency and good management."[15]

The proposed order would also contravene our international trade policy agenda.[16] The United States has long advocated that its trade partners, such as the European countries, move away from the government-regulated programs of the past and allow the free market system to ensure that supply

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[13] Ex. 23 (Henry von Eichel, The Hop Marketing Order) at 2.
[14] Tom Gasseling of the Proponents Committee testified that if base costs would rise to as much as $2.00 per pound of hops, his own operation might "go broke"; he also acknowledged that other growers hypothetically could go bankrupt as well. Gasseling Tr. 599-600; See also Smith Tr. 336 (base cost as much as $3.25 per pound under previous order).
[15] Kloth Tr. 658-59. (quoting United States Dept. of Agriculture, Food and Agricultural Policy—Taking Stock for the New Century, at 51 (Government Printing Office 2003)).
[16] Id. at 659.

meets demand.[17] For the United States to adopt anti-free market principles domestically would undermine our credibility as well as our negotiating positions internationally, all for a program that is inequitable, strongly opposed at least by a very substantial plurality, if not a majority, of hop growers and will shift hop market share overseas.[18]

Finally, some of the proponents surprisingly testified that the market, which was only in oversupply during the past three or four years in the first instance because of recent developments of super-high alpha hops,[19] has already corrected due to market responses as well as the German crop failure.[20] Considering all of the possible negative effects of the proposed order, it makes absolutely no sense to consider the drastic step of a marketing order when its proponents acknowledge that the market is in balance

It is now up to the USDA to decide whether to send the proposed order to a grower referendum, which would result in this process continuing at a minimum into Spring 2004. Delaying a decision into the coming hop-planting season would only encourage over-production of unwanted hops in 2004 by growers seeking to exit the market, but who continue to hope that an order will

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17 Id.
18 Id.
19 Smith Tr. 196-201, 291.
20 Smith Tr. 291, 302; see also Carpenter Tr. 121-22 (free market forces are bringing current supply in line with demand).

give them their "exit strategy."[21] Conversely, passage of the order would only hurt the majority of hop growers. USDA should immediately halt the order process to prevent further damage to the U.S. hop industry, damage that has been exacerbated over the past two years as some growers have put off difficult decisions trying to achieve a decision as a collective with respect to a market that needs to be addressed as individual growers or private grower groups.

C. Standard and Procedures for Establishing Marketing Orders

A marketing order may be promulgated only if, after a formal rulemaking hearing conducted pursuant to 5 U.S.C. §§ 556 and 557, the Secretary of USDA finds "upon the evidence introduced at such hearing" that the order "will tend to effectuate the declared policy" of the Marketing Act.[22] The policy of the Marketing Act is twofold: 1) To gradually increase returns to the producers of the commodity, so long as the price of the commodity does not exceed parity; and 2) to maintain orderly marketing conditions so as to avoid unreasonable fluctuations in supplies and prices.[23]

Proceedings to promulgate marketing orders are governed by the formal rulemaking procedures set forth in the Administrative Procedure Act, 5 U.S.C § § 556 and 557 Pursuant to these provisions, "(t)he transcript of testimony

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[21] See Ex. 23 at 2 ("exit strategy" tied to base allotment value and lack of reduced acreage in 2001-02. Proponent Committee member Stephen Carpenter testified that the original exclusion of the 2002 growing season for the base allocation period was originally designed not to encourage growers to plant hops to gain base. Carpenter Tr. 102. Another proponent, Henry Tobin, testified that 2001 should be the year used for determining voting rights because, in his opinion, this was "the last year you could say very few games were played by growers to improve their personal situation regarding the marketing order. Tobin Tr. 2245-46.
[22] 7 U.S.C. § 608c(4).
[23] 7 U.S.C. § 601.

and exhibits, together with all papers and requests filed in the proceeding, constitutes the exclusive record for decision . . . ."[24] Moreover, a marketing order may not be promulgated "except . . . in accordance with the reliable, probative, and substantial evidence."[25] Finally, proponents of the marketing order have the burden of proof of establishing that the proposed order should be promulgated.[26]

USDA will evaluate the hearing record and prepare a recommendation for public comment. After reviewing any comments submitted by February 2004, USDA will decide whether or not to proceed to the next potential stage of the process, which would be a producer referendum to determine support for the proposed order.[27] If USDA were to decide that proponents had met burden of proof, the order would become effective only if approved either by two-thirds of the producers voting in the referendum, or by those representing at least two-thirds of the hops grown by those voting in the referendum.[28]

II. Proposed Order would Not Increase Grower Returns or Stabilize Prices

The evidence compiled at the hearing leaves no doubt that proponents of the proposed order have failed to carry their burden of proof. To the contrary, the evidence conclusively shows that the proposed order in its

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[24] 5 U.S.C. § 556(e).
[25] 5 U.S.C. § 556(d).
[26] Id. ("proponent of a rule or order has the burden of proof").
[27] USDA AMS News Release No. 210-03.
[28] Id.

present form would not increase growers' prices and would not stabilize hop prices.

Specifically, the hearing record demonstrates that global competition would defeat the proposed American hop cartel. In addition, proponents have not established that the HAC could accurately read a dynamic hop market, and, even if it could, the HAC would not have the market power to keep hop prices stable. Moreover, currently efficient American growers, to maintain or expand current production trying to meet demand for their hops, would receive decreased profits because they would be burdened with purchasing base allotments from growers without such demand. Realizing that proponents have not established that the proposed order would work in the face of foreign competition, faced with indisputable evidence of the unfairness inherent in the base allocation system, and remembering the failures of past hop marketing orders, the grower community is deeply divided over the proposed order.

A. Global Competition would Defeat American Hop Cartel

The problem perceived by proponents of the order is an oversupply of high alpha, not aroma, hops. This is reflected in the fact that under the proposed order, those varieties with an alpha acid of 10 percent or less (i.e., aroma hops) would be considered equal to 10 percent of pounds of hops produced when allotting base.[29] This is also reflected by testimony from a

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[29] Proposed Order § 991.53(a)

number of proponents.[30]

The proposed order then is specifically designed to increase alpha hop prices by forming a cartel to regulate the available supply of alpha hops. Foreign competition, however, will defeat any attempt by the HAC to reduce the supply of alpha hops to increase returns for American hop growers.

There can be no question that the market for hops is global. American hop growers exported 51.75 million pounds of hops in 2002, supplying countries all over the world.[31] U.S. hops are sold to approximately 75 countries,[32] and approximately 70% of U.S. growers' sales are outside the United States.[33]

While American growers compete in a global market, they provide a relatively small percentage of the global supply for hops. In 2002, foreign hop growers supplied approximately 72%[34] of the world's hops and 64.4%[35] of the world's hop alpha acid. Apparently, foreign suppliers gained market share in 2003, because proponents' expert, Dr. Folwell, testified that foreign growers

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[30] Carpenter Tr. 93; Smith Tr. 318, 344; Paul Serres. Tr. 2011; Reggie Brulotte Tr. 2198.
[31] Ex. 38 (Hop Growers of America 2002 Statistical Report) at 17. Smith Tr. 265 (market for alpha acid is competitive on a global basis. Roy Tr. 1607 (American growers not immune to foreign growers).
[32] Dr. Mark Jekanowski Tr. 1414.
[33] Ex. 23 at 2.
[34] Ex. 38 (Hop Growers of America 2002 Statistical Report) at iv.
[35] Id. From 1992 to 2002, U.S. alpha acid production decreased from 6,953,000 to 6,922,000 lbs. while German alpha acid production increased from 3,053,000 lbs. to 6,505,000 lbs.

supplied approximately 77.5% of the world's hops in 2003.[36]

Moreover, the percentage of foreign high alpha hop production is increasing as foreign producers, including those in Germany, China, and Eastern Europe, continue to switch their acreage from aroma to high alpha varieties. The transition to alpha hops has been startling; while total (aroma and alpha) hop acreage worldwide decreased from 178,000 to 134,958 acres between 1992 and 2002, alpha hop acreage increased from 64,625 to 68,341 acres.[37]

For example, in 1994, the average alpha content in a pound of German hops was 3.7%; by 2002, the percentage had risen to 9.3%.[38] Proponents acknowledged that there has been a significant and rapid increase in high alpha hops in Germany.[39] Likewise, Chinese growers are currently switching to high alpha varieties, and away from low-yielding, low alpha varieties.[40] Proponent Michael Smith testified that in recent years Chinese growers have planted high alpha hops, and that it is certainly possible that China will increase its production of high alpha hops.[41]

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36 Folwell Tr. 894.

37 Ex. 38 at 11.

38 Id. at 15.

39 Smith Tr. 204, 211, and 292 (from 1993 to 2002, there has been a significant and rapid increase in high alpha hops in Germany). See also Ex. 40 (The Barth Report 2002/2003) at 12 (7% increase in high alpha acreage in Germany in 2002 over 2001).

40 Id. at 23.

41 Smith Tr. 369-73. Dr. Luther Tweeten, the agricultural economic expert for some of the opponents to the proposed order also sees a significant competitive threat from China. Tweeten Tr. 1191 ("the Chinese are incredibly innovative and it won't be long, if it hasn't happened already, that they will be up to speed in terms of technology).

Overall, hops are grown in many countries around the world.[42] Foreign suppliers of alpha hops, of course, would not be subject to the order's supply controls. Indeed, without being exhaustive, there is abundant evidence, expert and layman alike, that foreign alpha hops producers would view an American hop marketing order as a signal to increase production, defeat any attempt to increase returns for U.S growers and capture a greater share of the world market than they would otherwise be able to secure.[43]

Even proponent growers and their economic expert had to acknowledge the presence of strong foreign competition.[44] Yet they provided no credible evidence as to how the marketing order would achieve its goals in the face of that foreign competition. Indeed, one of the chief proponents acknowledged that prices may not rise as a result of the order, and that U.S. growers would

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[42] One leading industry publication, the Barth Report, identifies 30 hop-growing countries. Ex. 40 at 7. One Proponent Committee member identified England, Spain, Bulgaria, the Czech Republic, New Zealand and Tasmania as major growing areas, in addition to Germany and the United States. Roy Tr. 1465-66. Proponents' economic expert also identified Australia, Belgium, China, France, Poland, Portugal, Russia, Slovenia, the Ukraine, Yugoslavia and South Africa. Folwell Tr. 894.

[43] Ex. 23 at 2. Tweeten 1132 (marketing order "would compromise the industry's competitiveness and market share in international trade"); Paul Fobert Tr. 801 (all order would do is transfer more acreage to Europe); Joseph Morrier Tr. 1738 (". . . we might well lose our marketing to Europe and Asia. We didn't have much Asia competition 10 years ago like we have today"); Kevin Riel Tr. 2340-41 ("extremely hard to deny fact" that foreign market share would expand under order); G. Eric Desmarais 2384 ("fully expect" Germany to expand production in face of order); Edward Shinn 1751-52 (describing decline of U.S. share of mint market under mint order); Charles Stauffer 1763 (one of the big risks of proposed order would be loss of market share to other countries); Martin Ungewitter Tr. 1777; Kloth Tr. 652.

[44] Smith Tr. 265 (market for alpha acid is competitive on a global basis; Mr. Smith acknowledges there could be an increase in supply from the Germans in response to a decrease in American hops); Roy Tr. at 1607 (American growers "not immune" to foreign growers); Folwell Tr. 1157-58 (proponents' economic expert admitted that there could be a significant supply response to a cut in the U.S. supply within just one season).

lose market share under the order.[45]

Moreover, the proponents' own economic expert was left to testify that "[w]e just hope" that the proposed order would result in higher prices for American growers, but admitted that he did not know if it was achievable.[46] He also was forced to admit that his own study probably demonstrated that the demand for U.S. hops is elastic,[47] which would further prove that U.S. growers do not possess any market power. While there was a complete absence of solid evidence that the order would achieve the required goals, there was abundant evidence presented that an order would result in a downward spiral of eroding U.S. grower market share and an increasing shift to foreign producers.[48]

American growers are particularly vulnerable because so much of their sales, 70% in 2002,[49] are outside the U.S. For example, it would appear that U.S. imports into China and other parts of Asia would be particularly exposed to competition from Chinese growers,[50] and 15% of all exports by American

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[45] Smith Tr. 288, 300 (not sure prices would be determined by the proposed order; order may not increase prices over today's pricing); Id. at 373 (Mr. Smith believes that the U.S. will lose market share with or without an order). Roy Tr. 1630 (raising price not an objective of the proponent committee). See also Proponent Michael Hogue 2363 (U.S. growers know that order is not about raising prices); Proponent Serres Tr. 2012 ("[r]egulating 26% of the world crop will have little effect on price").
[46] Folwell Tr. 899.
[47] Dr. Folwell tried to establish that demand for hops is inelastic so that a reduction in the U.S. supply could result in increased prices; in so doing, Dr. Folwell attempted to dispute analysis by an economic expert for some of the opponents (including Anheuser-Busch), Dr. Mark Jekanowski, demonstrating the price elasticity of hops. Ultimately, however, Dr. Folwell had to acknowledge that his own analysis indicated the probability that the demand for hops is elastic. Folwell Tr. 869-70, 878. He also admitted that the drastic price rise during the previous order was due to a German crop failure, not because of the order. Id. at 899.
[48]. See notes 43-44.
[49] Ex. 23 at 2.
[50] A. Gamache Tr. 2321 (recognizing potential dangers of U.S. exports into China); Riel Tr. 2342 (could "easily picture" scenario where China could be "a major player in the global alpha market in the future"); Desmarais Tr. (once you open the door to the Chinese "it's going to be much tougher dealing with them").

growers went into Asia in 2001-2002.[51] Similarly, 30% of all U.S.-grown exports went into Europe, the home of the most fôrmidable foreign competitors, the Germans.[52]

Nor was any credible evidence produced that the order would result in more "stable hop prices". Free market forces, aided by the ever-increasingly accurate information available to growers that proponents have identified, will always result in better decision-making than any centralized planning committee. The HAC's eight growers would not have enough market information or vision to make better decisions than the ninety-plus grower operations currently in the marketplace For example, the last time centralized planning prevailed, <u>i.e.</u>, under the previous marketing order between 1966-1986, the HAC failed to protect U.S. growers "from a severe and costly market contraction in the 1980's".[53] Moreover, unrebutted economic expert testimony established that prices were much more <u>unstable</u> during the period when the previous order was in effect than since the termination of the order.[54]

Faced with this evidence to the contrary, proponents did not explain how the HAC would be any more successful than its predecessor in stabilizing prices. There was absolutely no process or techniques described by which the

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[51] Ex. 38 at 16.

[52] Id.

[53] Exhibit 40 at 21. Interestingly, under the previous marketing order, spot prices fell to less than 50 cents per lb. (the level that has been cited as a rationale for the proposed order). Smith Tr. 283-84.

[54] Exhibit 30 (Dr. Mark Jekanowski, Sparks Companies, Inc., An Economic Analysis of the Proposed Marketing Order for Hops) at 43. <u>See also</u> Smith Tr. 361-62 (admitted there was much price volatility under the previous order due to "a significant error" by the previous HAC); Folwell Tr. (admitted that his statement in Exhibit 27 that "the degree of price variability during the life of the [previous] order has been less than half that experienced otherwise" did not take into account sharp price increases between 1980 and 1982.)

HAC could accurately determine hop market supply and demand to determine the "correct" amount of saleable hops in any given year.[55] Indeed, proponents expressed uncertainty on the subject that price stability would be achieved.[56]

Moreover, proponents' economic expert, testifying in response to questions from an attorney from the Antitrust Division of the U.S. Department of Justice, admitted that a HAC can only "fairly accurately" read the market when it is stable, and that "the more variation in supply and demand," the harder it is to make predictions.[57] He also acknowledged that crop failures and surpluses from other countries could not be forecasted,[58] and that "there's always the possibility any time you're projecting something out 18 months into the future, that you're not going to be 100% accurate."[59]

In summary, proponents acknowledged the admittedly failed experience under the previous hop marketing order, testified they do not know whether the current order would work, stated that they hoped the HAC would "learn from the mistakes" of the previous HAC, but provided no evidence as to how the proposed HAC would do a better job than the previous one.[60] On the other

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55 For example, Mr. Gasseling testified that the proponents did not even take past years, where supply and demand are known quantities, and apply any methodology to demonstrate how the saleable quantity could be determined. Gasseling Tr. 1982-83.

56 Smith Tr. 272, 286 and 325 (Mr. Smith does not know whether the proposed order will stabilize prices and could not state that the HAC would operate the proposed order correctly; under previous order there was a shortage "that was beyond anyone's expectation" and then "greed got in the way of good decisionmaking"). Carpenter Tr. (Mr. Carpenter "hopes" the HAC will be able to balance supply and demand).

57 Folwell Tr. 980-83.

58 Id. at 899.

59 Id. at 1162.

60 See notes 53-59 and accompanying text. See also Smith Tr. 287 ("learn from past mistakes"). See also Serres Tr. (proponent acknowledged that he could not think of any case where a committee has done a better job of allocating resources).

hand, opponents were adamant in their opposition to the HAC.[61]

B. Inequitable Cost of Purchasing Base would Burden Efficient Growers, Including Aroma Hop Growers

There was evidence during the hearing to the effect that the order is viewed as an "exit strategy" where exiting growers with insufficient demand for their hops will receive artificially-created value in the form of payments for base allotments needed by other growers to meet demand for their hops.[62] There was substantial evidence provided by proponents and opponents alike that the value of base allotments could, and probably would, be substantial.[63] Proponents acknowledged, and even asserted, that base allotments would have a substantial value, presumably because this would be a selling point for the proposed order for those growers who want to exit the industry by selling all of

[61] Desmarais Tr. 2378-9 ("it has been testified by a number of different opponents" that it would be "very difficult, if not impossible," for a group of his peers to make decisions for him; also "completely inappropriate" for 7-9 growers decide things legally that can cause financial harm to people he did not even know); Annen Tr. 763 (President of Oregon Hop Growers' Association testified it is very dangerous to have eight people making decisions for the entire industry); Kloth Tr. 655 ("central committee management simply does not work"); Shinn Tr. (impossible for a HAC "to know the ins and outs of my finances and obligations"); Tweeten Tr. 1196 (Dr. Tweeten summarized his view on the ability of a HAC to accurately set an annual saleable amount of hops to satisfy anticipated world demand by stating "if horses were dreams, beggars could ride").

[62] Ex. 23 at 2. See also Charles Stauffer Tr. 1760-61 ("Why should the responsible grower pay the price for the irresponsible grower?")

[63] Smith Tr. 336, 346-47 (base cost as much as $3.25 per lb. under old order; aroma hop growers could face increased costs from acquiring base); Roy Tr. 1605, 1614-15 (base will create increased costs for some growers; order would be inequitable at outset because some growers will have to buy base); Folwell Tr. 909-10 (competitive disadvantage between one American grower having to buy base and one selling base; the competitive disadvantage could be exacerbated by reinvestment of base sales by sellers of base); Annen Tr. 748 (any saleable set below 85% would require his operation to buy base); Riel Tr. 2357 (potential bidding war for base); Desmarais Tr. 2383 (potentially high cost for base); Gooding Tr. 477-78 (President of Idaho Hop Growers' Association testified order would unfairly add costs to his operation because it would have to acquire base; he had to acquire base under the previous order and it hurt his operation; cost of base was $1 per lb. in 1979); Obendorf Tr. 498 (plans to expand, but would have to acquire base which would be uneconomical).

their base allotment, or who anticipate selling excess base as a valuable commodity.[64]

Regardless of proponents' motivation, there is no doubt that such payments would constitute a substantial extra cost for growers who have to acquire base allotments, and an unfair windfall for growers with excess base to sell, growers who would receive that base for nothing.[65] Indeed, considering there is no evidence that growers will realize higher prices as a result of the order,[66] the <u>only</u> "value" created by the proposed order would be merely the inequitable redistribution of wealth from growers needing base to growers with excess base, with no net increase in industry wealth.[67]

Conversely, since some of the recipients of this inequitable wealth redistribution would be exiting the industry, and because of the expected loss of market share to foreign competition, the hop industry as a whole would

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[64] Smith Tr. 336, 346-47; Roy Tr. 1605, 1614-15; Carpenter Tr. 97, 105-06 (potential for base purchases exists; concern that substantial cut in saleable will increase cost of base); Serres 2025 (expanding producer would most likely have to buy a lot of base in the event of a drastic cut in the saleable quantity).

[65] Proposed Order § 991.53(a).

[66] <u>See</u> notes 45-47 and accompanying text.

[67] Proponents conceded in testimony that these base transfers would be inequitable. <u>See</u> note 61. <u>See also</u> Gasseling Tr. 606-07 (Mr. Gasseling testified that he does not know of any type of mandatory program that is fair to everyone – that there are going to be "some people have a certain situation that's not going to benefit them"); Id. at 1883 (noting inequities under previous order); Carpenter Tr. 105 (would appear to be inequitable that a grower who has expanded and has been competitive would have to purchase base from another grower); Duane Desserault Tr. 2293-94, (grower down from 300 to 100 acres would receive base from production over 300 acres; might increase acreage at expense of current grower having to cut acreage; would have to think about whether that is fair; later noted that expanding grower having to buy base should have to share burden borne by Mr. Desserault for hops that he has not grown over the past 3-5 years due to his inability to find a market for those hops). Of course, opponents agreed. Annen Tr. 2166 (thinks it would be un-American to have to buy base to expand); Kerr Tr. 783 ("marketing order would force us to either reduce our acreage further or face financial hardship of acquiring more base allotment. Neither of these options would be fair . . .").

suffer a net loss in wealth.[68] This attempt of inequitable wealth redistribution from some American growers to others (some of whom would exit the market), to the detriment of the hop industry as a whole, cannot be a valid rationale for an order.

Although the order seeks to protect the aroma hop segment of the industry, aroma growers would be forced to buy allotment base, which would damage the healthy aroma segment. Specifically, under the proposed base allotment scheme (whereby growers' allotment base would be determined by their highest volume year in the past six years), the initial industry allotment base would be much higher than 2002 production levels; one conservative estimate was that the initial allotment base would be approximately 9.2 million pounds of alpha acid as compared to 6.9 million pounds produced in 2002.[69]

To then reduce the current supply of hops, a drastic reduction in the saleable quantity would be necessary. One economic expert predicted that to reduce current supplies in any substantial manner, the saleable quantity would need to be cut to 55.4% of the initial base allotment.[70] Such a sizeable restriction would ensure that growers of aroma hops, 95% of which is contracted, would be forced to absorb higher costs in the form of the purchase of allotment base, or to reduce planting resulting in fixed costs spread over

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[68] See Exhibit 23 at 2 (exit strategy). See also notes 42-44 (foreign competition), 62-63 (cost of base) and accompanying text.
[69] Exhibit 30 at 16.
[70] Id. at 11-18.

fewer hop pounds.[71] This would necessarily result in them either having to try to sell the hops at an artificially higher price or their customers being driven to foreign sources

The testimony of a Washington hop grower, Eric Desmarais, provides a concrete example of the inequity and costs that would be imposed on American alpha and aroma hop growers under the proposed order. Mr. Desmarais provided unrebutted testimony that if the saleable quantity were cut by a mere 30% (which was estimated to equal 2002 alpha production), and if the price of base were only 50 cents per pound, it would still cost his operation approximately $400,000 to acquire the base needed to meet his projected 2004 production, all of which is under contract.[72]

Considering proponents' own testimony that base under the previous order was sold at multiples of more than six times that amount,[73] and considering his conservative estimate of the cut in saleable quantity as compared to Dr. Jekanowski's, Mr. Desmarais's base acquisition costs could be several times higher than even his substantial projection. As Mr. Desmarais testified that he does not have the financial resources to purchase base, such costs may prevent him from meeting his contractual obligations, and

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[71] The following aroma growers testified that they would, or may have to acquire base or cut production, at least with a sizeable cut in the saleable. Jon Weilmunster (Tr. 510) (reduced crop for 2nd-year grower could put him out of business); Stephen Carpenter (Tr. 105-06); John Annen (Tr. 748); Eric Desmarais (Tr. 2376); Andrew Kerr (Tr. 783); Charles Stauffer (Tr. 1760); Jon Weilmunster; Michael Gooding (Tr. 477-78); Gregory Obendorf (Tr. 498). See also Edward Shinn Tr. 1751 (aroma grower had to buy base under previous order, and continued paying for purchases for three years after termination of order).

[72] Desmarais Tr. 2372-78.

[73] Smith Tr. 336.

in any event would be grossly unfair to him and his family.[74] Many other growers expressed opposition to the order because of the inequity of having to purchase allotment base from growers who would receive it for free.[75]

The testimony by Mr. Desmarais, an aroma hop grower for Anheuser-Busch, is also a stark example of the anticompetitive cost burdens that the proposed order would impose on aroma hop growers, specifically. As the record demonstrates, aroma hop returns have generally been profitable because 95% of aroma hops have historically been sold under contract.[76] example, Anheuser-Busch has historically offered multi-year aroma hop contracts that were good and profitable for the growers who received returns and enjoyed an extended planning horizon.[77] The record also shows that Coors Brewing has entered into multi-year hop contracts that have given growers a fair return.[78]

In Anheuser-Busch's experience, these contracts were also good for Anheuser-Busch as they gave us supply assurance, allowed us to secure our varietal preference, and allowed us to procure hops that met our quality standards at a competitive cost.[79] In short, our contract program formed a

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[74] Desmarais Tr. 2372.
[75] See opponent transcript cites in notes 63, 67 and 71.
[76] Kloth Tr. 654; see note 30 and accompanying text (aroma hops generally in balance).
[77] Id. at 652-53; see also notes 10-11 and accompanying text.
[78] Steve Rockhold Tr. 407-08.
[79] Kloth Tr. 653.

supply/demand equilibrium that benefited both grower and customer.[80]

During the past decade, direct purchases in the form of multi-year and forward contracts have fulfilled a substantial majority of Anheuser-Busch's hop requirements.[81] Our reasons for initiating the direct-to-growers program included our desire to establish long-term relationships with growers that have efficient operations and are prepared to make investments in growing the varieties we require subject to our quality control standards.[82]

The proposed order would impose an environment that would challenge our ability to continue to achieve the objective of long-term relationships with efficient American growers.[83] Under the order, Anheuser-Busch would have no incentive to offer multi-year contracts because we would have no assurance that American aroma hop sources, burdened by the extra costs of purchasing base allotment (as exemplified by Mr. Desmarais's testimony), would be competitive with alternative sources.[84] Indeed, the mere presence of the proposed order has already negatively affected aroma growers and Anheuser-Busch because it has forced us to wait to see the final outcome of the proposed HMO before we move forward with multi-year contracts.

Under normal circumstances, Anheuser-Busch could self-protect its supply needs by growing more hops ourselves, but under the proposed order, the expected drastic cut in saleable allotment would force Anheuser-Busch to

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80 Id.
81 Id. at 656.
82 Id. at 656-57.
83 Id. at 657.
84 Id.

cut back production of its own hops.[85] In the late 1980's, Anheuser-Busch invested significant capital to grow a portion of its hop requirements. It would be grossly unfair to force Anheuser-Busch to cut back production of its existing operation for its own brewing use.[86] Moreover, the ½% annual saleable allotment increase allowed in the proposed order for existing operations would continue to prevent Anheuser-Busch from supplying its own hop needs.[87]

C. <u>Buyer Consolidation Rationale</u>

Perhaps realizing the overwhelming evidence against the merits of the proposed order, proponents came up with a new rationale during the hearing, <u>i.e.</u>, that the order is needed to offset a loss of grower bargaining power because of an alleged recent consolidation of hop buyers. In brief, there was testimony that there are fewer handlers of hops, and that the order would create a competitive market by giving growers more power <u>vis a vis</u> buyers.

This argument is a red herring, however, because there is no provision in the proposed order that would reduce the number of sellers of hops.[88] number of sellers would remain exactly the same with or without an order. were relevant, however, there are plenty of buyers and potential buyers in the hop market. While several handlers remain (John I. Haas/Barth, S.S. Steiner,

[85] Id. at 654-55.
[86] Exhibit 22 at 4.
[87] Proposed Order § 991.53(e)(1).
[88] Proposed Order.

and Janicke),[89] recent years have also seen the development of grower groups, such as Hop Union, Yakima Chief, and the HPG Grower Cooperative in Germany, marketing their products directly to brewers.[90]

For example, Yakima Chief, a grower group, sells 25-30% of U.S. grown hops directly to brewers around the world.[91] Hop Union is a smaller grower group that apparently sells to the craft brewing industry.[92] In addition, according to Mr. Smith, two grower-owned companies provide "the vast majority of hops to the craft brewing industry" (comprised of over 900 brewers), yet Mr. Smith testified that there is no seller control over the price in these sales.[93]

Moreover, there was testimony of a growing trend toward direct purchases by brewers, exponentially increasing the number of purchasers and potential purchasers. For example, over the past decade, direct purchases from growers have come to fulfill a substantial majority of Anheuser-Busch's hop requirements.[94] Coors has been buying hops directly from growers for decades.[95] There was also testimony that other major brewers are exploring direct purchases.[96] With the trend toward direct purchases, and with the presence of thousands of potential purchasers in the form of small, medium

[89] Smith Tr. 249; Folwell Tr. 923.
[90] Smith Tr. 249, 254.
[91] Smith Tr. 219, 275-76.
[92] Id. at 254.
[93] Id. at 319-20.
[94] Kloth Tr. 656.
[95] Rockhold Tr. 408.
[96] Annen Tr. 2163-65 (major European brewer actively seeking grower groups for large purchases of alpha acid). Gasseling Tr. 2078-79 (there well may be other direct sales to major brewers other than Anheuser-Busch and Coors).

and large brewers,[97] there is plenty of fragmentation of buyers and potential buyers, again, if this issue were relevant to the consideration of the proposed order.

Finally, there was no evidence produced of any relationship between pricing problems since 2000 and the number of hop buyers, while there was abundant evidence that the development of super alphas and an ensuing alpha glut caused the fairly temporary imbalance in supply, and the concurrent temporary drop in prices.[98]

D. There is Strong Grower Opposition to the Proposed Order

Realizing the proposed order would not produce increased grower profitability, and recognizing the gross unfairness of the allotment base system, grower opposition to the proposed order is very strong. At the hearing, more growers testified against (16) than for (15) the order.[99] Administrative Law Judge Clifton noted that the evidence at the hearing reflected "sharp disagreement" over the proposed order.[100]

Indeed, the record shows that <u>all</u> Idaho hop growers are resolutely

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[97] Smith Tr. 251.

[98] Smith Tr. 196-201, 291; Ex. 8 at 10; Ex. 40 at 8.

[99] Growers who testified against the proposed order: John Annen, Jeff Butsch, G. Eric Desmarais, Paul Fobert, Aaron Gamache, Michael Gooding, Andrew Kerr, Don Kloth (Anheuser-Busch), Joseph Morrier, Gregory Obendorf, Kevin Riel, Edward Shinn, Charles Stauffer, Martin Ungewitter (S.S. Steiner), Peter Vandeneynde (John I. Haas), and Jon Weilmunster,. Growers who testified for the proposed order: Ronald Brulotte, Reggie Brulotte (same operation as Ronald Brulotte), Stephen Carpenter, Duane Desserault, Kenneth Desserault, Dale Gamache, Darren Gamache, Thomas Gasseling, Michael Hogue, Gary Morford, Daniel Newhouse, Leslie Roy, Paul Serres, Michael Smith, and Henry Tobin.

[100] Tr. 2459.

against the order.[101] Moreover, the president of the Oregon Hop Growers' Association, John Annen, testified that as of August 2003, growers representing 35 of 38 Oregon hop grower numbers were also opposed to the order.[102] Mr. Smith acknowledged that only "a portion of the industry" wants the proposed order.[103] Mr. Carpenter of the Proponents Committee acknowledged that there were no Oregon and Idaho members on the committee and that Oregon growers had stated that Washington growers were "part of the problem."[104] Clearly, there is no industry consensus for the order. Conversely, the industry is deeply divided.[105] Considering the strong grower opposition, as well as all of the potential harm that an order would likely create, it is very surprising that this proposal has gone as far as it has, particularly considering proponents' stunning admission that the alpha hop market is now in balance.

E. Conclusion

Anheuser-Busch believes that a study of the record by an impartial fact-finder will thoroughly establish that proponents failed to establish that the proposed order would result in greater returns and market stability for U.S. growers. Because of foreign competition and additional costs that would be imposed on U.S. growers by having to purchase allotment base, the hearing testimony confirms the opposite in both respects.

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[101] Exhibit 21 (Idaho Hop Growers, Letter to Secretary of Agriculture Anne Veneman).
[102] Annen Tr. 746, 764-65.
[103] Smth Tr. 287.
[104] Carpenter Tr. 118-19.
[105] Exhibit 40 at 21. The most up-to-date number of grower operations is that there are approximately 93-95 growers (33 Oregon; 54 Washington , 5-6 Idaho and possibly 1-2 California). Carpenter Tr. 2263-67.

Finally, it is undisputed that under the proposed order there would be winners and losers among the growers simply due to the manner in which the order would work. Let there be no mistake. The record is clear on this. We believe as a matter of basic fairness, that it would be inappropriate for the U.S. government to knowingly impose a system on an industry that preordains winners and losers, particularly when the market is admittedly in balance.

Delaying the likely defeat of the proposed order by sending it to a referendum will only encourage over-production of unwanted high-alpha hops in 2004, again resulting in lower prices for American growers. Conversely, in the unlikely event the order were to be enacted through referendum, all of the evidence suggests that it would result in a downward spiral of eroding market share and reduced profitability for American growers.

For these reasons, USDA should immediately halt the order process, and send the urgently needed yet delayed message that free market forces will allocate American hop industry resources.

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Respectfully submitted,

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Certificate of Service

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